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The Role of Corporate Governance, Dividend Policy, and Capital Structure on Ownership Structure Toward the Firm Value

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Abstract:

The purpose of this study was to determine the role of corporate governance, dividend policy and capital structure on ownership structure toward the firm value. The study was conducted to manufacturing firms listed at the Indonesia Stock Exchange during 2008-2011. The results showed that institutional majority ownership structure is the cause of agency problems, which can be mitigated by corporate governance mechanism and dividend policy, thereby increasing the value of the of the company. Capital structure can be used as a mechanism to reduce agency problems but cannot affect the value of the company due to the implementation of the company's corporate governance resulting in increasing debt in the capital structure and dividend policy. Dividend policy and capital structure is not a substitute nor complementary in reducing agency problems.

Keywords: Ownership Structure, Corporate Governance, Capital Structure, Dividend Policy, Firm Value

1. Background and Goals of the Study

Gigonani *et al.* (2011) suggest that two types of agency problems; vertical agency problem that exist between owners and managers and horizontal agency problems that exist between controlling (majority) shareholders and minority owners. Separation of ownership and control functions within the company creates agency problems when potential managerial behaviors (agents) are not in accordance with the interests of shareholders (principals) (Jensen and Meckling, 1976), and differences in the interests of the majority shareholders to minority shareholders (Shleifer and Vishny,1996), as found in Indonesia, as a developing country, in which institutional shareholders become the majority shareholders and will do expropritaion to minority shareholders (Alwi, 2009).

The agency problems affect capital structure requirements and dividend policy as a monitoring mechanism on managerial behavior (Jensen and Meckling, 1976). In addition, the agency problems can be mitigated through monitoring done by creditors by means of the company's capital structure, to ensure that the actions done by shareholders (majority) are in accordance with the interests of creditors (Alwi, 2009) and the use of dividends as the monitoring of capital markets (Easterbrook, 1984).

Dividend policy is the substitution of capital structure on textile company and a complementary mechanism without the ownership structure in reducing the agency problems. The use of dividend policy and capital structure will give effect to the agency costs that companies use as a substitute, as reported by Ramachandran and Packkirisamy (2010) who did research on a textile company, or as a complementary (Noronha et al.,1996). At the time when dividend policy possess higher agency costs compared with the use of debt in the capital structure, the company funds its operation from debt; meanwhile, funding for operation will be taken from dividend policy when the agency cost is lower than the debt in the capital structure so resulting in ineffective monitoring. This implies on the need of alternative monitoring to reduce agency problems (Farinha, 2003) such as the implementation of corporate governance (Al-Shabibi and Ramesh, 2011; Dharmastuti and Wahyudi, 2013).

Corporate Governance (CG) is an alternative mechanism to reduce the agency problems since it can become a controlling tool on the decisions taken by the company—taken based on the interests of managerial behavior and by considering protection toward investors and creditors. The implementation of corporate governance is mandated in Act Number 40 Year 2007 regarding Limited Company (Ltd) and Number 8 Year 1995 on capital markets to protect the interests of investors and creditors.

Shleifer and Vishny (1996) describe that the implementation of CG in a company will increase the demand made by creditors because of the guarantee of better governance (supply-view), such as the research by Mousavi et al. (2012); but the increase in debt in the capital structure will increase the risk of bankruptcy. Thus, companies with good governance will reduce the possibility of debt in the capital structure (demand-view), such as research by Mai (2010) and Hasan and Butt (2009).

Dividends distributed to shareholders is an indication that the company has good governance or, as La Porta et al. (2000) state, an outcome hypothesis, such as research by Jiraporn et al. (2011). On the other hand, dividends can be used as a mechanism to build the company's reputation with poor governance (substitution hypothesis), such as research by Devi and Subramaniam (2011) which find a negative but insignificant results.

Indonesian Stock Exchange (IDX) statistics showed that manufacturing sector has funding needs and dividend distribution that are higher than the primary and tertiary sectors, from the data on primary and tertiary sectors throughout 2008-2011. This will potentially make agents and shareholders in manufacturing companies to act in an opportunistic way in the use of debt in its capital structure and dividend policy.

Based on the previous description, the ownership structure causing the agency problems in a manufacturing company can be reduced through the implementation of corporate governance, dividend policy and capital structure, meaning thatr corporate governance will provide protection to creditors in providing credit and to investors in dividends divided thus affecting the value of the company. However, previous studies show inconsistencies in findings so reassessment on theories is required. The description of variables and indicatos (is shown in table 1), as well the conceptual framework of this study is shown in figure 1

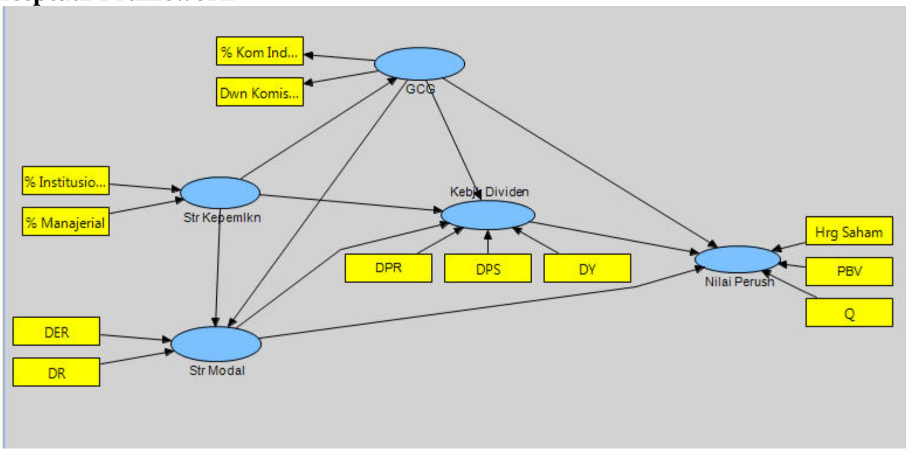
Table 1: Variables and Indicators

No	Research Variables (latent)	Indicators	Notation in Model
1	Ownership Structure (X1)	1.1.Managerial Ownership	% Manajerial
		1.2.Institutional Ownership	% Insitusional
2	Corporate Governance (Y1)	2.1.Number of commissioners	Dwn Komisaris
		2.2.Proportions of independent commisioners	% Kom Independent
3	Capital Structure (Y2)	3.1.Debt equity ratio	DER
		3.1.Debt ratio	DR
4	Dividend Policy (Y3)	4.1.Dividend yield	DY
		4.2.Dividend payout ratio	DPR
		4.3.Dividend per share	DPS
5	Firm Value (Z1)	5.1.Stock price	Hrg Saham
		5.2.Tobins Q ratio	Q
		5.3.Price book value	PBV

Source: previous research

So, in the present study attempt has been made to study the role of corporate governance, dividend policy, and capital structure on ownership structure toward the firm value. Further the discussion has been divided into four sections. *Section 2* explains research methodology used in the study. *Section 3* shows results of study. Finally, *section 4* represents conclusions of the study.

Figure 1: Conceptual Framework



This study is to analyze the roles of the corporate governance, dividend policy, and capital structure on ownership structure toward the firm value with explain of research problems in this study are (a) whether ownership structure affect corporate governance, (b) whether ownership structure affects capital structure, (c) whether ownership structure affects dividend policy, (d) whether corporate governance affects the capital structure, (e) whether corporate governance affects dividend policy, (f) whether capital structure affects dividend policy, (g) whether corporate governance affects firm value, (i) whether capital structure affects firm value, and (j) whether dividend policy affects company value.

2. Research Method

The quantitative approach to the study under explanatory design aimed to test the hypothesis according to research problems. Secondary research data was derived from the Indonesian Capital Market Directory (ICMD) that comes with the annual report and the Indonesian Stock Exchange (IDX) Statistics 2008-2011 for manufacturing companies. Samples were chosen though a purposive sampling technique, for companies that (a) pay dividends, (b) have managerial ownership, and (c) have independent commissioners as part of the company board of commissioners--10 samples were obtained for each of the four-year period, so there were 40 units of observation.

Measurement of variables consisted of (a) the ownership structure, that is managerial ownership referring to the percentage of stock owned by directors and commissioners in comparison to the number of shares outstanding (Indahningrum and Handy, 2009) and institutional ownership, that is the percentage of share owned by institution compared to the number of shares outstanding (Wen and Jia, 2010); (b) corporate governance, namely (ln) the number of board commissioners (Hassan and Butt, 2009) and the percentage of independent commissioners in the board of commissioners (Wulandari and Widaryanti, 2008); (c) the capital structure, that is debt equity ratio which refers to the percentage of debt compared to equity and debt ratio—debt ratio is the percentage of debt compared to total assets (Abu-Rub, 2012); (d) the dividend policy, that refers to dividend payout ratio which is the ratio of earnings per share distributed to the shareholders (Hussainey et al., 2011), dividend yield is the ratio of stock prices compared to cash dividends (Abdelsalam et al., 2008) and dividend per share which is the (ln) of the actual cash dividends (Ullah, 2012); (e) the value of the company, namely Tobins Q (the ratio of the market value of shares compared to book value of debt (Abu-Rub, 2012); price-book value is the ratio of the market price of the stock compared to its book value (Stella, 2009) and stock price is (ln) year-end stock price (Waweru et al., 2012).

This study used a descriptive and analytical path analysis, that was the partial least square (PLS) due to the tiered effect on the variables of the study and the need of comprehensive analysis. Data analysis of PLS was conducted using SmartPLS and followed two-stage approach for assesing the outer model and the inner modal respectively.

3. Results and Discussion

3.1 Descriptive Analysis

Descriptive analysis is analysis to describe the general condition of the data such as total sample, minimum number of the sample, mean, and standard deviation. The outputs for descriptive data of this study are shown in **Table 2**. The results of the descriptive statistics show that the manufacturing companies had large variations in price-book value, while the dividend yield had small variations.

Table 2: Descriptive Analysis

	Mean	Std. Deviation
Institutional Ownership	.6322	.19058
Managerial Ownership	.0758	.10676
Number of Board Commissioners	5.9250	2.91229
Proportion of Independent Commissioners	.3984	.13110
Debt Ratio	.3633	.14872
Debt Equity Ratio	.7667	.63374
Dividend Payout Ratio	.4297	.72697
Dividend per Share	221.9250	272.91479
Dividend Yield	.0521	.04754
Tobins-Q	.9292	.79479
Price Book Value	1.9095	1.99766
Stock Price	9805.5000	17771.39890

Source: Results of Analysis

The descriptive statistics show that the manufacturing companies included some sub-sectors. Those sub-sectors were automotive and components (4 firms), tobacco manufacturers (1 firm) Miscellaneous Industry (3 firms), food and beverages (1 firm), cable (1 firm)

3.2. Path analysis

Structural equation models usually involve latent variable with multiple indicator (table 1) and followed two-stage approach for assesing the outer model and the inner modal respectively

The measurement model or outer model specifies the relationship between and indicators and latent variabel. Testing outer model is a test on indicator of variables, that can be described in a formative model that is in the ownership structure, dividend policy, capital structure, and firm value and reflective model on corporate governance variables .Using a two-tailed test with a significance level of 10%, the outer model will be significant if the t-statistics is larger than 1.684. The results of outer model is as shown in Table 3

Based on table 3, there were 2 indicators in measuring corporate governance:number of board Commissioners, proporton of independent Commissioners. Capital structre while all the loadings were greater than 1.684, hence there were 2 indicator to measure. Capital structure: debt equity ratio and debt ratio. There were 2 indicators in measuring dividend policy and fimr value. Dividen policy:dividend yield and dividend per share, firm value: tobinsQ and sotck price. But in measuring ownership structure: 1 indicator (institutional ownership)

The results showed that the ownership structure was not the cause of the agency problems because manufacturing companies had relatively small proportion of managerial ownership, which was only 7.58%. Arifin (2005) mentions the small proportion of managerial ownership does not lead to opportunistic behavior who only acts in his/her own interest. This results do not support the "opportunism behavior of agent" but support that organizational managers' main motivations are to serve the organization's best interest and mission. According to it, the manager seeks essentially to do a good job and be a good steward of the firm assets (Donaldson and Davis, 1991). The empirical fact (table 2) shows that the average institutional ownership in the observation periode was above 50%, ie 63.22% respectively for the years 2008, 2009, 2010 and 2011. This means that institutional ownership have absolute voting power to expropriation minority shareholders.

Dividend payout ratio is not an indicator of dividend policy because managerial stock ownership is not opportunistic in the allocation of retained earnings. PBV is not an indicator of the value of the company as it relates to the activities of investment companies, not to the dividend policy and capital structure. Mulyono

(2011) proves that PBV can be used in setting investment strategy because by using PBV ratio, investor can predict which stocks will be undervalued and overvalued so the can gain significant return.

Table 3: Outer Model Output

Indicators	Loading factors
corporate governance -> Number of Board Commissioners	3.962
corporate governance -> Proportion of Independent Commissioners	11.345
Managerial Ownership -> Ownership structure	0.798
Institusional Ownership -> Ownership structure	4.072
DPR -> dividend policy	0.116
DPS -> dividend policy	3.169
DY -> dividend policy	2.902
DR -> capital structure	4.798
DER -> capital structure	1.829
PBV -> firm value	0.318
Q -> firm value	1.740
stock price -> firm value	9.928

Source: Results of Analysis

The inner model spesifies the relationships between unobserved or latent variables. Testing of inner models is used to test the hypothesis in accordance with the conceptual framework of the research. The results of inner model is as shown in Table 4

Based on the formulation of the problem research that have been built as well as analysis of the research, conclusions can be summarized as follows:

1. Corporate governance and dividend policies *is showing a* significant role on ownership structure toward the firm value. Effect of each independent variable on the corporate governance, dividend policy, capital structure and firm value are as follows:
   a. Ownership structure have a significant positive affect on corporate governance
   b. Ownership structure have a significant negative affect on dividend policy
   c. Corporate governance have a significant positive affect on firm value
   d. Dividend policy have a significant positive affect on firm value
   e. Corporate governance have a significant positive affect on dividend policy.
   f. Corporate governance have a significant positive affect on capital structure
2. Capital structure’s is not showing a signifikan role on ownership structure toward the firm value. Effect of each independent variable on the corporate governance, dividend policy, capital structure and firm value are as follows:
   a. Effect of ownership structure on capital structure is significantly negative
   b. Capital structure variables do not have significant affect on firm value
   c. Capital structure variables do not have significant affect on dividend policy
   d. does not affect the dividend policy

Table 4: Inner Model Output

Independent	Dependent	*Orignal Sample*	t-test	Decision
Corporate Governance	Dividend policy	0.7569	13.7199	Significant
Corporate Governance	Firm Value	0.1721	2.8845	Significant
Corporate Governance	Capital Structure	0.2934	3.7685	Significant
Dividend Policy	Firm Value	0.8036	14.0548	Significant
Ownership Structure	Corporate Governance	0.3067	4.4010	Significant
Ownership Structure	Dividend Policy	-0.2901	2.6528	Significant
Ownership Structure	Capital Structure	-0.6421	12.927	Significant
Capital Structure	Dividend Policy	-0.1194	1.3098	Insignificant
Capital Structure	Firm Value	0.0676	1.2136	Insignificant

Source: Results of Analysis

4. Conclusion

The results of hypothesis testing showed that the agency problems were caused by institutional shareholders, which does not support the statement by Jensen and Meckling (1976) which states that managerial shareholders have opportunistic behavior. Increased institutional shareholders who did expropriation to the minority shareholders will increase the need for monitoring of capital markets through dividends (Easterbrook, 1984); monitoring of creditors (Alwi, 2009) and corporate governance (Dharmastuti and Wahyudi, 2013). However, there was not any relationship found between the capital structure and dividend policy, as to give a signal of good corporate governance, the company implements dividend payout policy (outcome hypothesis) and increases debt as a result of the creditors' demand (supply-view). This implies that the use of debt resulting in reduced cashflow does not affect the company's dividend distribution to shareholders. That implies that an increase in debt in the company's capital structure does not increase the risk due to good corporate governance; thus, companies with capital structure from debt or non-debt will not experience an effect on their value. Dividend policy can reduce agency problems, and investors in Indonesia are characterized by their willingness to get dividends than capital gains. Therefoe, dividend policy and governance that provide a guarantee for dividend payment to investors can increase the value of the company.

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